DEPARTMENT OF STATE REVENUE

04-20100212.LOF

Letter of Findings Number: 10-0212
Use Tax
For Tax Year 2007

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ISSUE

I. Use Tax–Recreational Vehicle.

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); Helvering v. Gregory, 69 F.2d 809 (2d Cir. 1934); Comm'r v. Newman, 159 F.2d 848 (2d Cir. 1947); Comm'r v. Transp. Trading & Terminal Corp., 176 F.2d 570 (2d Cir. 1949); Horn v. Comm'r, 968 F.2d 1229 (D.C. Cir. 1992); Lee v. Comm'r, 155 F.2d 584 (3d Cir. 1998); IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1; 45 IAC 2.2-3-4.

Taxpayer protests the imposition of use tax on the use of a recreational vehicle.

STATEMENT OF FACTS

Taxpayer is an individual and is a resident of Indiana. The Indiana Department of Revenue ("Department") determined that on June 9, 2007, Taxpayer purchased a recreational vehicle ("RV") in Kentucky and had been using the RV in Indiana and other states without paying sales tax in any jurisdiction. As a result, the Department issued proposed assessments for use tax, ten percent negligence penalty, and interest. Taxpayer protests that the RV was titled by a Montana LLC, of which Taxpayer and his wife are the sole members, and that no Indiana sales or use tax is due. An administrative hearing was conducted and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax–Recreational Vehicle.

DISCUSSION

Taxpayer protests the imposition of use tax on the use and storage of an RV in Indiana. The Department imposed use tax after determining that Taxpayer had been using and storing the RV in Indiana and that no sales tax had been paid on the purchase of the RV. Taxpayer protests that the RV was titled by a Montana LLC and that all legal documents establishing the existence of the LLC were properly filed in Montana. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The sales tax is imposed by IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

The use tax is imposed under IC § 6-2.5-3-2(a), which states:

(a) An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Also, 45 IAC 2.2-3-4 provides:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Therefore, when tangible personal property is acquired in a retail transaction and is stored, used, or consumed in Indiana, Indiana use tax is due if sales tax has not been paid at the point of purchase. The Department determined that Taxpayer purchased the RV in Kentucky in a retail transaction on June 9, 2007. The Department therefore issued proposed assessments for use tax.

At the hearing, Taxpayer stated that the RV was used approximately 40 percent of the time in Indiana and 60 percent of the time in other states. Taxpayer also asserted that Taxpayer's home in Indiana was the "home base" from which RV travel was done.

As explained in Taxpayer's June 11, 2010, affidavit, Taxpayer's reason for forming the LLC was to "ease the processing of title work, ease the registration and renewals," give "liability protection," and provide "favorable insurance and financing arrangements and favorable taxation in Montana." At the hearing, Taxpayer stated that the LLC had no other activity other than the purchase of the RV.

As provided by Article III of the LLC's Articles of Organization (dated June 21, 2007):

The LLC is formed to conduct and promote any lawful business that acquires by purchase, lease, or other means any personal property and/or real property and to hold or dispose of it.

Also, the insurance renewal notice, dated May 14, 2008, establishes that the address the LLC uses for anything not filed in the state of Montana (Montana vehicle registration and Montana Secretary of State approval letter are addressed to Missoula, Montana) is the same as Taxpayer's Indiana residential address.

Article I, paragraph 3, of the LLC's Operating Agreement (dated July 4, 2007) states that:

> The business of the LLC shall be the acquisition of real and personal property as the Members may agree and to conduct or promote any lawful business within Montana or any other jurisdiction which a LLC is legally, allowed to conduct business.

Taxpayer also provided a copy of the minutes to the LLC's first and only meeting, at which the members agreed to execute any purchase agreements, notes or contracts as necessary for the purchase of the RV on behalf of the LLC. There is no mention of how the LLC would use the RV to conduct business but it is stated that the LLC, of which Taxpayer and his wife were the only members, would allow Taxpayer and his wife to operate the RV. The minutes of the meeting are dated July 4, 2007. Taxpayer also provided a copy of a letter from the Montana Secretary of State's office (dated June 22, 2007) which states that the Montana Secretary of State's office accepted the filing of the documents for the LLC.

These documents constitute the entire evidence of the LLC's existence. There are no documents establishing any business activity at all in Indiana, Montana, or any other state in the union. The LLC was not pursuing its stated reason for existence, which was to conduct business. While the LLC made no attempt to undertake any business activity, the titling of the RV by the LLC did have a significant impact on Taxpayer's sales taxes.

This leads to consideration of the "sham transaction" doctrine, which is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id. at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and "[T]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id. at 470.

The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Comm'r v. Transp. Trading & Terminal Corp., 176 F.2d 570, 572 (2d Cir. 1949), cert. denied, 338 U.S. 955 (1950). "[T]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Comm'r, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992). In determining whether a business transaction was an economic sham, two factors can be considered; "(1) did the transaction have a reasonable prospect, ex ante, for economic gain (profit), and (2) was the transaction undertaken for a business purpose other than the tax benefits?" Id. at 1237. The question of whether or not a transaction is a sham, for purposes of the doctrine, is primarily a factual one. Lee v. Comm'r, 155 F.3d 584, 586 (2d Cir. 1998).

In this case, the facts are that the officially stated purpose of the LLC's formation was to conduct business, but that the Montana LLC had no business functions and never attempted to conduct any business of any kind. The titling of the RV in Montana, a state without a sales tax, was merely an attempt to reduce or eliminate Taxpayer's sales and use tax liabilities. The formation of the LLC and the titling of the RV in the name of the LLC was therefore a "sham transaction."

Taxpayer argues that the formation of the Montana LLC was not a sham transaction and offers a quote which Taxpayer states was written by Judge Learned Hand. The quote provided by Taxpayer states:

> Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury. There is not even a patriotic duty to increase one"ss taxes. Over and over again courts have said that there is nothing sinister in so arranging one"s affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands.
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> (Taxpayer's protest letter, dated March 22, 2010).

A review of the "quote" reveals that it is actually pieced together from two different opinions written by Judge Learned Hand. The first two sentences of Taxpayer's "quote" are found in the case Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934), in which Judge Learned Hand wrote, "Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one"s taxes." The second two sentences of Taxpayer's "quote" are found in the case Comm'r v. Newman, 159 F.2d 848, 850 (2d. Cir. 1947), in which Judge Learned Hand provided in the dissenting opinion, "Over and over again courts have said that there is nothing sinister in so arranging one"s affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant."

There are several problems with Taxpayer's reliance on these words written by Judge Learned Hand. The first is that in Helvering v. Gregory, Judge Learned Hand also wrote:

> We do not indeed agree fully with the way in which the Commissioner treated the transaction; we cannot treat

> as inoperative the transfer of the Monitor shares by the United Mortgage Corporation, the issue by the Averill Corporation of its own shares to the taxpayer, and her acquisition of the Monitor shares by winding up that company. The Averill Corporation held a juristic personality, whatever the purpose of its organization; the transfer passed title to the Monitor shares and the taxpayer became a shareholder in the transferee. All these steps were real, and their only defect was that they were not what the statute means by a 'reorganization,'-- because the transactions were no part of the conduct of the business of either or both companies; so viewed they were a sham, though all the proceedings had their usual effect. But the result is the same whether the tax be calculated as the Commissioner calculated it, or upon the value of the Averill shares as a dividend, and the only question that can arise is whether the deficiency must be expunged, though right in result, if it was computed by a method, partly wrong. Although this is argued with some warmth, it is plain that the taxpayer may not avoid her just taxes because the reasoning of the assessing officials has not been entirely our own.
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> Order reversed; deficiency assessed.
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> (Gregory, 69 F.2d at 811)
>
> (Emphasis added).

Therefore, Taxpayer in the instant case has referred to an opinion which states that the taxpayer in that case took part in a sham and was not allowed to avoid her just taxes. Also, as previously mentioned, the taxpayer in that case appealed to the United States Supreme Court in the case Gregory v. Helvering. As provided above, the Supreme Court agreed that the business arrangement was a sham and that the taxes were properly due.

Regarding the language Taxpayer takes from Newman, it is important to note that Judge Learned Hand's words are found in the dissenting opinion. That case also holds that a taxpayer's attempts to reduce taxation were invalid. It should also be noted that Newman does not discuss the sham transaction doctrine, but rather discusses technicalities of New York state trust laws. The court stated:

> It is obvious that if the experiment succeeded, the grantor and his wife would be in a position to realize great savings in tax bills by adding to the trust funds. The weakness in the scheme, however, is one inherent in respondent"s intention. That intention, it seems clear, was to show on the face of the documents a technical absence of his control over the fund, while actually retaining the power to use the fund as he saw fit. Since he retains this beneficial power, the income from the trusts is taxable to him and he is subject to a deficiency assessment.
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> (Newman, 159 F.2d at850).

Neither of the cases from which Taxpayer pieced together the Judge Learned Hand "quote" support Taxpayer's protest. Quite to the contrary, they support the Department's determination that Taxpayer's Montana LLC was in fact a sham transaction and that use tax is properly due.

Additionally, the RV was invoiced in Kentucky on June 9, 2007, while the LLC's documents were not signed or filed until June 22, 2007. This means that Taxpayer purchased the RV and then contributed it to the LLC. Since Taxpayer is an Indiana resident and he purchased the RV, he should have paid sales tax or use tax.

In conclusion, the formation of the LLC and the titling of the RV by the LLC was a sham transaction. Also, the timing of the purchase of the RV by Taxpayer and contribution of the RV to the LLC would still require sales or use tax be paid by Taxpayer. Either of these reasons alone would establish that Taxpayer acquired tangible personal property in a retail transaction, used and stored it in Indiana, but did not pay sales tax at the point of purchase or anywhere else. In such circumstances, Indiana use tax is due, as explained by 45 IAC 2.2-3-4.

FINDING

Taxpayer's protest is denied.

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